



DCAA

DEFENSE CONTRACT AUDIT AGENCY

Indirect Costs

INDEPENDENT

One Agency, One Team, One Direction

Today's Discussion

- Fundamental concepts related to indirect cost allocation.
 - Differences between overhead and G&A pools.
 - Understanding allocation bases.
 - Pool & Base relationship.
 - Significance of indirect rates.
- Examples
- Summary

What is a Final Cost Objective?

- The purpose for which costs are measured.
- A final accumulation point for all recorded costs.
- A product, contract, job, task, delivery order, etc.
 - Final cost objectives receive both direct and indirect costs.

Indirect Costs

- Reasonable and necessary costs of doing business.
- Cannot be directly identified with a single contract.
- Logically *pooled* into homogenous groupings.
- *Allocated* equitably across all business activities, according to the benefits each gains from them.
- Allocated using a base which has a clear linkage to the pool.
- Any cost that is leftover after all direct costs have been identified and charged to the correct contract.

Indirect Costs



- To the extent that indirect costs are reasonable, allowable and allocable, they are a legitimate cost of doing business payable under a U.S. Government contract or grant.
- Costs incurred for the same purpose, in like circumstances, must be treated consistently for all contracts.

Indirect Costs

Common Cost Structures

- Overhead Pools:
 - Cost related to support of specific operations.
 - Manufacturing, Engineering, Material Handling, etc.
- General & Administrative Pools:
 - Management, financial, and other expenses incurred for the general management and administration of the business unit as a whole.
 - G&A, IR&D, B&P

Direct Vs. Indirect Costs*

Rent.....	Indirect
Freight on Direct Material.....	Direct
Packaging on a Contract.....	Direct
Supervisory Labor.....	Indirect
Property Tax.....	Indirect
Labor for a Job.....	Direct
New Hire Training.....	Indirect

*Represents the most common treatment for these costs; however, there may be acceptable exceptions.

Direct Vs. Indirect Costs*

Contract Material.....	Direct
Contract Travel.....	Direct
Office Supplies.....	Indirect
President's Salary.....	Indirect
Other Items on a Job.....	Direct

*Represents the most common treatment for these costs; however, there may be acceptable exceptions.

Allocation Base

- A measure of direct contractor effort that can be used to allocate pool costs based on benefits accrued by the several cost objectives.
- A means to equitably allocate indirect costs to cost objectives.
- This is what the pool is being allocated to.

Base - Examples:

- Direct Labor (hours or dollars),
- Direct Materials,
- Head count,
- Total Cost Input or Value Added Base,
- Quantity of Computers,
- Number of Machine Hours,
- Square footage, etc.

Example of a G&A Base

- Calculating a Total Cost Input (TCI) Base
 - + Contract Direct Labor
 - + Contract Direct Material
 - + Contract ODC
 - + Subcontract Costs
 - + Gross Overhead

= Total Cost Input

Example of a G&A Base

- What is the difference between TCI and Value Added Base?
 - + Contract Direct Labor
 - ~~- Contract Direct Material~~
 - + Contract ODC
 - ~~- Subcontract Costs~~
 - + Gross Overhead

 - = Total Cost Input**

Causal/Beneficial Relationship

If it were not for the base, the pool expense would not be incurred.

- No labor cost -- No fringe expense.
- No computers -- No computer service department.
- Significant decline in work -- Significant decline in pool expenses.
- No contracts -- Ultimate elimination of company.

Pool / Base Relationship

$$\begin{array}{l}
 \text{R} \\
 \text{A} \\
 \text{T} \\
 \text{E}
 \end{array}
 = \frac{\text{Pool - Expenses to be Allocated}}{\text{Base - Caused the Expenses or Benefits from the Expenses}}$$

Causal/Beneficial Relationship -- If it were not for the base, the pool expense would not be incurred.

Overhead Rate Example

Overhead Pool

Acct. No.	Description	G/L	Adj	Claimed	OH Base:
7001	Salaries & Wages	33,060		33,060	Direct Labor 633,012
7002	Postage & Handling	6,235		6,235	
7004	Small Equipment	878		878	
7011	Equipment Rental	27,150		27,150	
7016	Repairs/Maintenance	1,681		1,681	
8421	Leave	20,181		20,181	
8425	Severance Pay	32,419	(23,023)	9,396	
8427	Taxes	23,612		23,612	
8431	Workers' Compensation	3,311		3,311	
8435	Health Insurance	31,097		31,097	
8440	Life Insurance	6,833		6,833	
8445	Pension Plan	58,320	(8,612)	49,708	
8450	Miscellaneous	612		612	
	Total OH Pool	245,389	(31,635)	213,754	

$$\frac{\text{OH Pool}}{\text{OH Base}} = \text{OH Rate}$$

$$\frac{213,754}{633,012} = 33.77\%$$

G&A Rate Example

General & Administrative Pool

Acct. No.	Description	G/L	Adj	Claimed
8001	Salaries & Wages	90,007		90,007
8320	Legal Fees	1,744		1,744
8501	Travel	12,987	(1,295)	11,692
8503	Entertainment	484	(484)	-
8505	Advertising & Promotion	354	(287)	67
8522	Bad Debts	3,018	(3,018)	-
8527	Interest Expense	1,001	(1,001)	-
8521	Leave	2,321		2,321
8527	Taxes	3,815		3,815
8535	Health Insurance	8,912		8,912
8540	Life Insurance	1,087		1,087
8545	Pension Plan	12,318	(1,883)	10,435
8550	Miscellaneous	3,357		3,357
Total G&A Pool		141,405	(7,968)	133,437

G & A Base:

Direct Labor	633,012
Direct Travel	34,563
Direct Material	842,981
Other Direct Costs	172,105
Subcontracts	944,841
OH Expenditures	245,389
Total G&A Base	2,872,891

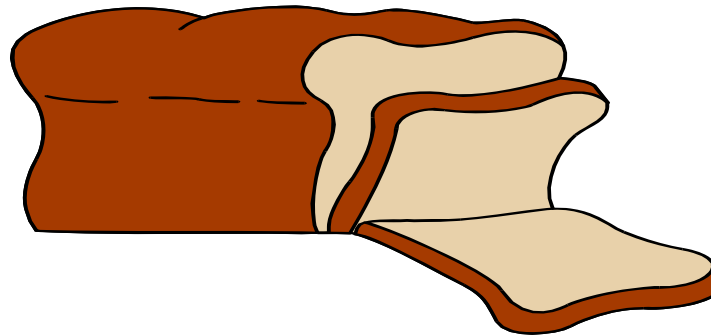
$$\frac{\text{G\&A Pool } 133,437}{\text{G\&A Base } 2,872,891} = \text{G\&A Rate } 4.64\%$$

What is Cost Allocation?

Peanut Butter = Pool

SPREAD IT OVER THE

Bread = Base



Indirect Rates

- Ratio between the total indirect expenses and some direct cost base.
- “Device” for determining fairly and conveniently what portion of indirect cost each contract should bear.
- Indirect cost rates are expressed in terms such as dollars per hour or percentage of cost.

Indirect Rates – Cont'd

- An Indirect Cost Rate by itself has very little meaning.
- The use of allocation bases and cost structures vary greatly among contractors.
- Indirect costs should not be compared between organizations at the rate level.
- The practice of direct or indirect charging is not an indicator of best value.

Allocating Indirect Costs

(4 Step Process)

1. Accumulate Costs (Pool):
 - Homogeneous; Logical Cost Groupings.
2. Select Allocation Base:
 - Causal or Beneficial Relationship.
3. Rate Computation:
 - Pool divided by base.
4. Rate Application:
 - Rate x Base Cost (Per Contract).

Questions?

